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Federal Tax Treatment of the Family

Frances M. Ryan

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FEDERAL TAX TREATMENT OF THE FAMILY*

FRANCES M. RYAN**

E. TRUSTS

In the golden era of trusts prior to the *Clifford* case, the legal ingenuity of the grantor's attorney was curbed by comparatively few income-tax statutes. Sections 162 and 163 determined what income was taxable and whether the tax should be paid by the trustee or by the beneficiary. Sections 166 and 167 related the exceptional cases in which the grantor of the trust was to be liable for the income tax. Section 166 provided (and still does) that:

> "Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—
>
> (1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or
>
> (2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom,
>
> then the income of such part of the trust shall be included in computing the net income of the grantor."

Similar provisions had been included in previous revenue acts, although prior to 1932 the grantor was held taxable on income under the section only if he held the power to revest either alone or in conjunction with a person not a beneficiary of the trust.[89] The change was made to prevent the grantor's keeping this power in substance by sharing it with one receiving a very minute benefit or none at all from the trust. It was felt that such a person would have little or no interest in keeping the trust alive and would be amenable to any suggestions made by the trustor.[90]

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**LL.B, Marquette Law School; LL.M., University of Michigan Law School; member of the Wisconsin Bar.

[89] A comparable section first appeared in the Revenue Act of 1924, Sec. 219(g), 43 Stat. 253, Public No. 176, 68 Congress, 1st Session.

[90] Report of Senate Finance Committee, No. 665, 72nd Cong., 1st Session, at p. 34.

Section 167 provides that a grantor shall be taxed on any part of the income of a trust if it:

> "(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or
>
> "(2) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, applied to the payment of premiums upon policies of insurance on the life of the grantor."

The history of this section is similar to that of Section 166. Prior to 1932 the section applied only if the discretion to use income in the manner indicated was lodged in the grantor alone or in conjunction with a person not a beneficiary of the trust,[91] which gave the trustor the same opportunities to control income that he then had to retain an untaxed control of the corpus. The statute was amended by the addition of subsection (c) in 1944 to provide that the grantor should be taxable only on that portion of the income which was actually applied to the support and maintenance of one toward whom he had such a legal obligation,[92] and not on any income that *might be* so applied, as was previously held.[93]

The metamorphosis caused by *Helvering v. Clifford*,[94] decided by the Supreme Court in 1940, was both complete and abrupt. In 1934 Clifford created a trust of certain securities which he then owned, making himself trustee. The trust was to run for a maximum period of five years, but might terminate sooner upon the death of either the grantor or his wife. During the term of the trust the grantor-trustee was to pay "in his absolute discretion" part or all of the income to his wife. Upon termination the corpus was to revert to the grantor and all accumulated income and the proceeds therefrom were to be paid to the wife. The grantor retained power to vote the stock put into the trust fund, to mortgage, sell, or pledge the shares, and to deal with the trust funds as he in his discretion saw fit. The instrument also provided that he should be responsible for no losses other than those caused by his "own wilful and deliberate breach of duties as trustee" and forbade the wife to anticipate her interest in any way. The trust agreement explicitly stated that the arrangement was not meant to relieve the grantor of his legal duties in support of his wife or family and that no restrictions were placed on the wife's use of the income received by her. The Board of Tax Appeals upheld the commissioner

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[91] *Supra*, note 89, Sec. 219(h).
[92] Revenue Act of 1944, Sec. 134, 58 Stat. 21, Public No. 235, 78th Congress, 2nd Session.
[93] Helvering v. Stuart, 317 U.S. 154, 63 S. Ct. 140 (1942).
[94] 309 U.S. 331, 60 S. Ct. 554 (1940).

in his decision that the husband, rather than the wife, was taxable upon the 1934 trust income. This decision was reversed in the circuit court and the government carried the case to the Supreme Court.

After reviewing the facts of the case, Justice Douglas quoted Section 22(a)[95] and stated that, "The broad sweep of this language indicates the purpose of Congress to use the full measure of its taxing power within those definable categories."[96] He then declared that it was the duty of the court not to let "technical considerations" obscure the basic issue; whether the grantor of a trust could still be treated as owner of the corpus, and observed that the answer to this question lay in an analysis of the circumstances of each particular case.

Perhaps nothing contained in judicial tax decisions is more frequently quoted than the list of factors upon which the court relied to find that Clifford was to be treated as owner of the corpus for income-tax purposes. These were: (1) the short duration of the trust, (2) the fact that the wife was the beneficiary, and (3) the retention of control over the corpus by the grantor. In arguing that these conditions equated to ownership, the justice stated:

> "So far as his dominion and control were concerned it seems clear that the trust did not effect any substantial change. In substance his control over the corpus was in all essential respects the same after the trust was created, as before. The wide powers which he retained included for all practical purposes most of the control which he as an individual would have. There were, we may assume, exceptions, such as his disability to make a gift of the corpus to others during the term of the trust and to make loans to himself. But this dilution in his control would seem to be insignificant and immaterial, since control over investment remained. If it be said that such control is the type of dominion exercised by any trustee, the answer is simple. We have at best a temporary reallocation of income within an intimate family group. Since the income remains in the family and since the husband retains control over the investment, he has rather complete assurance that the trust will not effect any substantial change in his economic position. It is hard to imagine that respondent felt himself the poorer after this trust had been executed, or, if he did, that it had any rational foundation in fact. For as a result of the terms of the trust and the intimacy of the familial relationship respondent retained the substance of full enjoyment of all the rights which previously he had in the prop-

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[95] Sec. 22(a) reads as follows: "'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service . . . of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. . . ."

[96] *Supra*, note 94, at 334.

erty. That might not be true if only strictly legal rights were considered. But when the benefits flowing to him indirectly through the wife are added to the legal rights he retained, the aggregate may be said to be a fair equivalent of what he previously had. To exclude from the aggregate those indirect benefits would be to deprive Section 22(a) of considerable vitality and to treat as immaterial what may be highly relevant considerations in the creation of such family trusts. For where the head of a household has income in excess of normal needs, it may well make but little difference to him (except income-tax-wise) where portions of that income are routed—so long as it stays in the family group. In those circumstances the all-important factor might be retention by him of control over the principal. With the control in his hands he would keep direct command over all that he needed to remain in substantially the same financial situation as before. Our point here is that no one fact is normally decisive but that all considerations and circumstances of the kind we have mentioned are relevant to the question of ownership and are appropriate foundations for findings on that issue. Thus, where, as in this case, the benefits directly or indirectly retained blend so imperceptibly with the normal concepts of full ownership, we cannot say that the triers of fact committed reversible error when they found that the husband was the owner of the corpus for the purposes of Section 22(a). To hold otherwise would be to treat the wife as a complete stranger; to let mere formalism obscure the normal consequences of family solidarity; and to force concepts of ownership to be fashioned out of legal niceties which may have little or no significance in such household arrangements."[97]

In the remainder of the opinion the relationship of Sections 166 and 167 to 22(a) is discussed, and it is stated that the former merely carve out of the area of taxable income a small group of cases in which the grantor is to be taxed; but that the sections are not exclusive and whenever it is found that the gain from a trust is really income to the grantor, as it is defined in Section 22(a), he may be taxed thereon whether or not the other sections are applicable. That Congress had not seen fit to lay down a "rule of thumb" for trust situations other than those covered by Supplement E of the Code only indicated, in the view of the Court, that it meant to "leave to the triers of fact the initial determination of whether or not on the facts of each case the grantor remains the owner for purposes of Section 22(a)."[98]

The usual flow of regulatory interpretations did not follow the *Clifford* case and from 1940 to 1946 the courts struggled, and sometimes not without complaints, to determine when "temporary reallocations" and "indirect benefits" spelled out taxability for the grantor. They could garner little aid from the statement in the decision that

[97] *Supra,* note 94, at 335ff.
[98] *Supra,* note 94, at 338.

"no one fact is normally decisive," but is merely "relevant to the question of ownership."[99]

This sentence was probably the one most responsible for the use of the decision as a "tax-the-grantor" precedent in a wide variety of situations. Since no one factor was controlling, it was not necessary that all three be present; at least, to the degree shown in the Clifford trust. The circuit courts varied in their applications of the doctrine. For example, in the second circuit the idea has been expressed that shortness of term alone may be sufficiently indicative of control.[100] On the other hand, it has refused to tax the grantor who retains power to vote stock of a trust, when such stock represents a controlling interest in his business.[101] During this six years the value of the short-term trust as a family security measure was considerably lessened.

Although one view was that the concept's greatest strength lay in the vagueness which gave it its elasticity,[102] the treasury eventually noted that "in the absence of precise guides supplied by an appropriate regulation, the application of this principle to varying and diversified factual situations has led to considerable uncertainty and confusion"[103] and set about to remedy the situation by the publication of the Clifford regulations late in 1945[104] and by amendments thereto in 1947.[105] The regulations provide that the income of a trust is to be taxed to the grantor if:

> "(1) the corpus or the income therefrom will or may return after a relatively short term of years;
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> "(2) the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition . . . whether by revocation, alteration or otherwise, exercisable by the grantor, or another person lacking a substantial adverse interest in such disposition; or both;
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> "(3) the corpus or the income therefrom is subject to administrative control, exercisable primarily for the benefit of the grantor."[106]

Paragraphs (c), (d) and (e)[107] further explain these conditions. In paragraph (c) a "short term" is defined as a period of ten years or

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[99] *Supra*, note 94, at 336.

[100] Commissioner v. Buck, 120 F.(2d) 775 (C.C.A 2d, 1941); Helvering v. Elias, 122 F.(2d) 171 (C.C.A. 2d, 1941), cert. den., 314 U.S. 692, 62 S.Ct. 361 (1941).

[101] Naylor, "Federal Tax Effects of Powers of Management and Control over Trust Investments," 41 Ill. L. Rev. 508 (Nov.-Dec., 1946). See cases cited at note 44.

[102] Pavensteat is often quoted as proponent of this view, expressed in "The Broadened Scope of Section 22(a): The Evolution of the Clifford Doctrine," 51 Yale L. J. 213 (Dec., 1941).

[103] Treas. Reg. 111, Sec. 29.22(a)-21(a).

[104] T.D. 5488, Dec. 29, 1945.

[105] T.D. 5567, June 30, 1947.

[106] Treas. Reg. 111, Sec. 29.22(a)-21(b).

[107] Treas. Reg. 111, Sec. 29.22(a)-21.

less. However, if the grantor, his spouse (living with him and not having a substantial adverse interest), or both of them retain administrative controls, the period is extended to fifteen years. Subparagraph (d) sets forth certain exceptions to subsection (b)(2). It states, among other things, that the tax will not fall upon the grantor if a trustee or trustees other than the grantor, a spouse living with him, a parent, relative or issue has the power, not subject to approval of any other person, to distribute, apportion, or accumulate income to or for beneficiaries, or to pay out corpus to them. If any of the excepted persons are given discretionary powers which may be used to affect the interests of beneficiaries which include the spouse or children of the grantor, further conditions are provided. If such person has a discretionary power to pay out corpus, it must either be limited by a definite external standard or payments must be charged against the proportionate share of the trust from which the income payable to such beneficiary arises. The power as trustee of a person in the family group to accumulate income can be exercised so as to save the grantor from the tax thereon only if it is ultimately paid to the beneficiary, his estate, or appointees. Further provisions, not pertinent to this discussion, are included.

Prohibited administrative controls are listed in subparagraph (e) and include powers exercisable by the grantor, or one not having a substantial adverse interest, or both to purchase, exchange, or dispose of corpus or income for less than an adequate consideration, to borrow from the trust without provisions for adequate interest and security, or to vote the stock, or control investments.

The regulations have made any one of the listed factors sufficient to establish the grantor's income-tax liability, and in this regard they go far beyond the *Clifford* case, in which a combination of circumstances was stressed. Over the years since the case was decided, the tendency has been to rely less upon the family factor than upon shortness of term and retained controls of one type or another. The regulations do not even mention the family relationship as one of the basic factors upon which tax liability of the grantor depends, although Section 29.22(a)-21(f) does contain the saving statement that, "The grantor may also be taxable on the income of a trust on the ground that such income is attributable to him in a capacity unrelated to dominion and control over the trust as such are defined in subsections (c), (d) and (e) of this section." Since most of the cases which might be affected by the regulations would, in the nature of things, involve family trusts, it was probably thought best not to list this factor and thus bluntly present the question whether the mere fact that a trust is to operate for the benefit of the grantor's family forestalls any income-tax shifting.

Although the regulations do in certain cases specifically deny any tax saving to a donor who makes a family member a trustee, probably their general effect upon the family trust is not great. The trial court is told, as before, that all circumstances of the arrangement are relevant to its decision and will, in all probability, continue to maintain, in general, the attitude of the Eighth Circuit that:

> "The decisions, of course, do not purport to hold that family relationship as such or alone can afford a sufficient basis for taxing the income of a trust to the donee, where he has retained no substantial elements or incidents of control over the property or its income. But where there is a retention of substantial control over the trust property or its income, the degree of family relationship involved, even without legal obligation of support, may well serve to intensify the economic focus of, and to bring into practical relief, the nature, purpose and effect of his control, in relation to his previous economic ownership and enjoyment . . . We think the family relationship may properly constitute a material factor in the fact-trier's evaluation of whether the nature, purpose and effect of the donor's control of corpus and power to command income may fairly represent to him in the particular situation on the economic equivalent of his previous ownership and enjoyment."[108]

Such a statement represents, of course, the more conservative view and rests upon the solid basis of the Supreme Court decision. One cannot help but notice again, however, that this whole area has been completely conquered by the "economic enjoyment" theory, a mercenary imported from the field of political economy and bringing with it the usual dangers of uncontrolled use in a strange environment.

One of the most frequent criticisms leveled at the present system is that of its lack of correlation of income, gift and estate-tax philosophy—particularly in the trust field. Under strict property law, ownership of the trust corpus passes from the grantor to another, but in order to defeat the use of this concept to achieve tax savings, several more informal ideas of ownership have been developed and woven into estate-tax statutes. The gross estate is defined in Section 811 of the Code. After subjecting the probate estate of the decedent to the tax, it lists various other property interests which are to be considered a part of his estate for purposes of taxation. Among them are transfers in contemplation of death, transfers taking effect at death, revocable transfers, and property subject to a power of appointment; any of which might have trust property as its subject matter.

Section 811(c) relates to transfers in contemplation of death, whether made by a gift outright or in trust. Of course, the statute

[108] Edison v. Commissioner, 148 F.(2d) 810, 814, (C.C.A. 8th, 1945), cert. den., 326 U.S. 721, 66 S. Ct. 25 (1945).

applies in any case in which a disposition in contemplation of death has been made, regardless of whether the donee is a member of the grantor's immediate family. However, the relationship might serve as evidentiary matter pointing toward the existence of such a motive in the making of the gift, and, in the nature of things, the statute is probably applied more often to gifts within the family circle than without it. Since the greater proportion of propertied persons desire to pass their holdings to the surviving members of their families, it is only natural that most inter vivos gifts, whether designed to avoid estate taxes or not, should be made to that class of recipients.

Section 811(c) also deals with gifts intended to take effect in possession or enjoyment at or after death and provides that they shall be included in the gross estate:

> "To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, . . . intended to take effect in possession or enjoyment at or after his death, or of which he has at any time made a transfer, by trust or otherwise, under which he has retained for his life or for any period which does not in fact end before his death (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person to designate the persons who shall possess or enjoy the property or the income therefrom; except in case of a bona fide sale for an adequate and full consideration in money or money's worth."

The federal estate-tax laws have contained a provision relating to "transfers intended to take effect in possession or enjoyment at or after death" since 1916. The latter part of the section, specifically levying a tax in cases in which the grantor retains a life interest in the transferred property, was added in 1931 after the Supreme Court decision of *May v. Heiner*,[109] wherein it was held that the mere reservation of a life estate by the grantor, without more, did not make the transferred portion taxable under the unamended provision.

With regard to the right of the grantor to change the beneficial ownership or enjoyment of corpus or income, the estate-tax law differs from the income-tax statutes. Under the latter the grantor is taxed on the income of a trust only if the power is held by him alone, by a person lacking a substantial adverse interest, or both.[110] Section 811(c) of the estate-tax law, however, provides that if such a power is reserved by the grantor "either alone or in conjunction with *any* person," the corpus will be held a part of his taxable estate. Therefore, he can avoid the estate tax only by giving the power to someone else and stepping out of the picture entirely. This, however, might not be

[109] 281 U.S. 238, 50 S. Ct. 286 (1930).
[110] *Supra*, note 105.

sufficient to enable him to shift the income tax; to do that, he would have to vest the power of disposition in someone with a "substantial adverse interest," although he might share the power with him, so far as the income tax is concerned. Probably the estate-tax requirements are more favorable to the taxpayer, since he still has the privilege of placing the power in one who will be apt to do his bidding, even though he cannot actually retain it himself.

In 1940 the case of *Helvering v. Hallock*[111] was decided, interpreting Section 811(c) broadly to include in the gross estate of the decedent the full value of any property in which he retained a contingent reversionary interest; a "string" which would be cut only by his death. In so deciding, the Court overruled it previous decision of *Helvering v. St. Louis Trust Company*,[112] wherein it had held that a possibility of reverter was not a property interest such as could pass to another at the death of the decedent and enlarge or ripen the interest of any grantee; but that death "simply put an end to what, at best, was a mere possibility of reverter by extinguishing it—that is to say, by converting what was merely possible into an utter impossibility."[113]

It soon became evident that the way had been opened to levy an estate tax on the basis of Section 811(c) upon every piece of property transferred subject to such a possibility of reverter, however valueless it might actually be.[114] However, the trend in this direction was halted by the promulgation of T.D. 5512 on May 2, 1946, amending Section 81.17 of the Estate-Tax Regulations. The new regulation brings into the foreground a requirement implicit in almost every one of the previously decided "possibility of reverter" cases.[115] It requires, first, in order to sustain a tax upon the estate of the deceased, that "possession or enjoyment of the transferred interest can be obtained only by beneficiaries who *must survive* the decedent" and, second, that "the decedent or his estate" possess some "right or interest in the property (whether arising by the express terms of the instrument of transfer or otherwise.)"[116]

To some critics the new regulation appears as a vast improvement, changing the Hallock decision "from a problem to a rule;"[117] while to others it is an unwarranted piece of treasury legislation and of doubt-

[111] 309 U.S. 106, 60 S. Ct. 444 (1940).
[112] 296 U.S. 39, 56 S. Ct. 74 (1935).
[113] *Ibid.*, at 43.
[114] Commissioner v. Field, 324 U.S. 113, 65 S. Ct. 511 (1945); Fidelity-Philadelphia Trust Co. v. Rothensies, 324 U.S. 108, 65 S. Ct. 508 (1945).
[115] Paul, *Federal Estate and Gift Taxation* (1946 Supplement), p. 198; Platt, "The New Hallock Regulation," 2 Tax L. Rev. 94, 95 (Oct.-Nov., 1946).
[116] Treas. Reg. 105, Sec. 81.17.
[117] Platt, *supra*, note 115, at 102. The regulation is also discussed with approval by Brown in "The New 'Hallock' Regulations," 83 Trusts and Estates 227 (Sept., 1946).

ful validity.[118] In any event, the new regulation should be easier on the taxpayer's pocketbook than the position formerly taken by the treasury that any reverter or retained interest made the estate tax inevitable.

Although not confined in its applications either to the family-transfer arena or to the field of devolutions in trust, Section 811(c) is often called into use against a transfer in trust for the benefit of family members. Again, this is only to be expected, as estate-tax law, though general in its wording, will be applied much more often than not to the intra-family transfers which most persons make at death or to the attempted testamentary dispositions made in lieu thereof earlier in life. The evident purpose of this section is, of course, to prevent tax avoidance by the use of inter vivos transfers, and one author has gone so far as to predict that it will eventually supplant the "contemplation of death" provision and that evidence of a tax-avoidance motive will be sufficient in itself to bring about a tax on the property conveyed.[119] This, however, seems unlikely in view of the limitations of the new "Hallock" regulation.

Section 811(d)(1) of the Code provides that the estate of the decedent will be taxed:

> "To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished in contemplation of decedent's death."

This section was first added to the estate-tax law by the 1924 Revenue Act. It has been subdivided and reworded by later amendments.[120] However, it has been decided that, even aside from the statute and as to trusts created before its passage, retention by the grantor of an outright power of revocation or termination subjects the property transferred to an estate tax at his death;[121] this being held on the ground that there has been no completed transfer.

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[118] Montgomery in his 1947-1948 edition of *Federal Taxes—Estates, Trusts and Gifts* refers to the section as "legalistic and lacking in substance," (p. 475). He suggests the abolition of the phrase "intended to take effect in possession or enjoyment at or after death" from the Code and the taxing of the actual value of the retained interest under 811(a).

[119] Paul, *Federal Estate and Gift Taxation* (1942), Sec. 7.05.

[120] The first such statute was contained in the Revenue Act of 1924, Sec. 301(d), 43 Stat. 253, Public No. 176, 68th Congress, 1st Session. See Paul, *ibid*, Sec. 7.06, for a detailed history of the section. Exhibit "B," facing page 395, shows clearly the various changes in the wording of the act which were made by amendments to it.

Cases arising under this section bear quite a resemblance to those to which the Clifford doctrine would be applicable in the income-tax field, and the problem is generally one of determining whether the various retained controls add up to a power of alteration or revocation; i.e., dominion and control over the property. However, the economic concept of the ownership in terms of command and enjoyment has not been carried so far in the field of estate taxes as it has with regard to the income tax, although a slow invasion is noticeable.[122] The section's general effect upon family trusts is much the same as that of the Clifford rule. It serves to impede the making of anything less than an absolute gift of property, whether in trust or otherwise. However, the donor may still avoid estate taxes by placing powers of alteration or revocation in someone other than himself.[123] Such person need not have a substantial adverse interest, as would be necessary if any income-tax shifting were to be achieved.[124]

Property subject to a power of appointment was first taxed under the 1918 Revenue Act. The act applied only to property "passing under a general power of appointment exercised by the decedent"[125] under certain circumstances. Problems constantly arose over what was meant by a "general power" and by its exercise. In 1942, therefore, the section was completely revised to levy a tax upon the estate of the donee of the power:

> "To the extent of any property (A) with respect to which the decedent has at the time of his death a power of appointment, or (B) with respect to which he has at any time exercised or released a power of appointment in contemplation of death, or (C) with respect to which he has at any time exercised or released a power of appointment by a disposition intended to take effect in possession or enjoyment at or after his death, or by a disposition under which he has retained for his life or any period not ascertainable without reference to his death (i) the possession or enjoyment of, or the right to the income from, the property, or (ii) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom; except in case of a bona fide sale for an adequate and full consideration in money or money's worth."[126]

[121] Reinecke v. Northern Trust Company, 278 U.S. 339, 49 S. Ct. 123 (1929).
[122] *Supra,* note 119, at page 310.
[123] An attempt was made in 1936 to make the property taxable as a part of the decedent's estate in cases in which a power of alteration, amendment, or revocation was given to any other person. See H.R. Rep., No. 2818, 74th Congress, 2nd Session, p. 9-10.
[124] Treas. Reg. 111, Sec. 29.22(a)-21(b)(2). I.R.C., Sec. 166, would apply to cases in which the power was one to revest title to any part of the corpus in the grantor.
[125] Revenue Act of 1918, Sec. 402(e), 40 Stat. 1057, Public No. 254, 65th Congress, 3rd Session.
[126] I.R.C., Sec. 811(f)(1).

Subsection (2) defines a power broadly to include "any power to appoint exercisable by the decedent either alone or in conjunction with any person." It then excepts from tax property subject to a power to appoint to certain types of charities or to a defined familial group, including none other than the spouse of the decedent or his spouse, descendants of the creator of the power (other than decedent) or his spouse, and spouses of such descendants. This section represents a definite effort on the part of Congress to preserve free from tax a valuable and flexible estate-planning device, as long as it is used in aid of the immediate family.

Prompted by similar motives, it also made an exception of a power held only in a fiduciary capacity for the benefit of a restricted group not including the decedent, his estate, his creditors, or those of his estate.[127] By meeting the terms of this section, the donor may create a power of appointment exercisable for the benefit of persons other than those listed in subsection (2)(a)—for example, his collateral relatives—without subjecting the donee to an estate tax at the latter's death. If, in either case, however, the power is exercised by the creation of a second power, the exception does not apply and the estate of the donee of the first power becomes taxable upon the property to the extent that it was made subject by him to a second power.[128]

Although open to minor criticisms,[129] the section is one of the more effective legislative attempts to curtail tax avoidance and at the same time one that shows ample consideration for the problems of a family-head who must map out such a financial course as to avoid an unplanned future for his family, on the one hand, and property-passing devices frowned upon by the Treasury Department, on the other.

Little help can be gained from the Code in determining when the donor of trust property becomes liable to a gift tax. The tax is imposed by Section 1000, regardless of "whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible."[130]

If a transfer in trust is determined to have been made in contemplation of death and an estate tax is levied upon the transferred property for this reason, a credit is provided for any gift tax which may have been previously paid.[131] The earlier imposition of the gift tax would have been dependant, however, on other characteristics of the trust.

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[127] I.R.C., Sec. 811(f)(2)(B).
[128] I.R.C., Sec. 811(f)(2).
[129] For an evaluation of the section in its present form, see: Paul, *Federal Estate and Gift Taxation* (1946 Supplement), Sec. 9.30-9.34; Montgomery, *Federal Taxes—Estates, Trusts and Gifts* (1947-1948 edition), p. 526.
[130] I.R.C., Sec. 1000(b).
[131] I.R.C., Sec. 813.

If a trust is intended "to take effect in possession or enjoyment" at or after the grantor's death in the sense that he has the power to change beneficiaries or alter their interests up to that time, the gift is not complete while such power is retained.[132] The same is true of a retained power to revoke the trust.[133] The regulations state, however, that, "A gift shall not be considered incomplete . . . merely because the donor reserves the power to change the manner or time of enjoyment thereof,"[134] and, in illustration, it is stated that a retained power in the donor to accumulate income for the benefit of the donee, if he so desires, and to pay it to him with the corpus at the end of the trust term will not stay the imposition of the gift tax. The regulations also state that the donor will be considered as having the power of disposition over the property if it is exercisable by him in conjunction with someone not having a substantial adverse interest therein.[135]

There is a completed transfer, taxable at its full value less the present worth of the donor's retained rights figured on an actuarial basis, if a possibility of reverter exists[136] or if the grantor retains economic benefits in the trust—such as a right to a part or all of the income for life—[137] but vests the remaining interests in others. If he sets up a trust for the support of his wife or the discharge of other family obligations during his life, however, there should be no gift tax, as the trust is being used only to carry out the duties for which he is legally responsible.[138]

The general theory underlying the gift tax is that it should be imposed whenever there has been a completed transfer whereby the donor has parted with all dominion and control over the subject matter of the gift.[139] Such a philosophy is better fitted for correlation with estate-tax than with income-tax statutes, and earlier cases indicated that the two were meant to supplement each other.[140] Later, however, an at-

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132 Sanford v. Commissioner, 308 U.S. 39, S. Ct. 51 (1939); Treas. Reg. 108, Sec. 86.3.

133 Burnet v. Guggenheim, 288 U.S. 280, 53 S. Ct. 369 (1933); Treas. Reg. 108, Sec. 86.3.

134 Treas. Reg. 108, Sec. 86.3.

135 *Ibid.*

136 Treas. Reg. 108, Sec. 86.2, Example (7).

137 See Paul, *Federal Estate and Gift Taxation* (1942), Sec. 17.12, for a discussion of the difficulties involved in rationalizing the estate and gift-tax treatment of property transferred in this manner.

138 Rudick, "Marriage, Divorce and Taxes," 2 Tax L. Rev. 123, 135 (Dec., 1946-Jan., 1947). If the trust is to extend for the life of a wife whose expectancy is greater than that of her husband, the trust does more than merely discharge the grantor's support obligation, which ceases at his death, and to the extent that it is so used, a taxable gift has been made. See, also, chart on pages 136-137 for a more detailed presentation of the income, estate, and gift-tax incidence as the terms of the support trust are varied.

139 I.R.C., Sec. 1000.

140 *Ibid.* This section also provides under certain circumstances for tax-free releases of powers created prior to January 1, 1939.

tempt was made to use the gift tax as a retriever of revenue lost through the reduction of surtaxes by means of transfers of income-producing property. Confusion has resulted from the casting of the gift tax in this double role, and the consequent uncertainty of the tax incidence of some types of transfers, together with the possibility of heavy multiple taxes, has made family transfers in trust of more dubious value.[141]

That the trust device has managed, however, to retain its usefulness in spite of treasury onslaughts from all three sides is evident from the number of trust cases which still come before the courts. Certainly, its inherent value as a transfer medium is not to be denied, and little could be said in favor of a system of taxation which would make it too expensive from the tax viewpoint to resort to the trust when called for by wise estate-planning. So far the present tax structure has not gone. Although the head of a family must be scrupulously careful about divesting himself of all indicia of ownership when making a trust settlement, if he is prompted by a genuine desire to provide for his family rather than merely to save taxes for himself or his estate, he need not pay too high a price for his transfer.

F. Community Property

It is probably because they never were solved that the tax problems raised by the diversities of the community-property and the common-law property systems continue to be of interest. One defeat after another met the ingenious tax-dodger who held his property according to English tradition, but they only served to highlight the favorable position of the residents of states which clung to a jurisprudence of Spanish origin, until the less conservative common-law states became willing to abandon their legal inheritance in favor of the tax savings to be obtained by the adoption of the community-property system.[142]

The question of income-tax treatment of holders of property in community was first ruled upon by Attorney General Palmer in 1920 and 1921,[143] when he held that spouses in all community-property jurisdictions, except California,[144] could pay their taxes separately, each

[141] If the husband, for example, sets up a trust, retaining the power as grantor, to apply the income for the support of his wife or to accumulate it for an adult son who is to receive both the corpus and accumulations on the termination of the trust, he is taxable on the trust income, must pay a gift tax on the value of the remainder and on any accumulations as made, and, in addition, the corpus will be included in his gross estate.

[142] See note 4, *supra*, for a list of the community-property states.

[143] 32 Op. Att'y Gen. 298 (1920); 32 Op. Att'y Gen. 435 (1921).

[144] California residents were denied the income-splitting advantage because the wife's interest there was only an expectancy and not a vested right under local law. This view was upheld in United States v. Robbins, 269 U.S. 315, 46 S. Ct. 148 (1926). Thereafter, the California law was amended to correct the former defect.

reporting one-half of the community income. This holding received the approval of the Supreme Court in the decision of *Poe v. Seaborn*[145] and its companion cases.[146]

In the *Seaborn* case the husband, a resident with his wife of the state of Washington, had recovered in district court an additional income tax paid by him under protest on the income from the community estate which, according to local law, was owned by his wife. The Supreme Court upheld the decision on the ground that "the wife has, in Washington, a vested property right in community property, equal with that of her husband; and in the income of the community, including salaries or wages of either husband or wife, or both."[147] The Court reviewed the powers of the wife arising from this "vested property right" and found them to be so substantial as to preclude any use of the "dominion and control" theory of taxation.

Throughout the years which followed, *Poe v. Seaborn,* decided on technical property concepts, stood more and more alone, as other cases in the income-tax field were judged less often by reference to local property law than to the "actualities" and "realities" of their situations. However, community income continued to be divisible, and the tax savings of wealthier community-property state residents were substantial.[148]

In 1939 Oklahoma attempted to obtain the tax benefits of the system by allowing her married couples to elect to hold property in community. The plan failed of its purpose, however, when the Court held[149] that it amounted to no more than an attempted assignment within the doctrine of *Lucas v. Earl.*[150] Thereafter, states which wished to obtain the advantages to be gained from the superposition of federal tax law upon a Spanish property system were forced to adopt the latter wholeheartedly and on a compulsory basis.

For a time community-property state residents were also favored by the estate and gift-tax laws. Prior to 1942 husband and wife were each treated as owner of one half the community wherever local law

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145 282 U.S. 101, 51 S. Ct. 58 (1930).

146 Three similar cases were decided at the same time. They were: Goodell v. Koch, 282 U.S. 118, 51 S. Ct. 62; Hopkins v. Bacon, 282 U.S. 122, 51 S. Ct. 62; and Bender v. Pfaff, 282 U.S. 127, 51 S. Ct. 64, arising in the states of Arizona, Texas and Louisiana respectively.

147 *Supra,* note 145, at 111.

148 The combined income-tax bill of spouses domiciled in community-property states has often been no more than 60% of the total tax paid by a couple similarly situated, but living in a common-law jurisdiction. On an average, income taxes have been 30 to 32 per cent lighter in the former group of states. This, of course, results from the opportunity of the community-property state residents to transfer that portion of the husband's income which would fall in the highest surtax brackets to the lower income-tax brackets available to the wife who has no separate income of her own.

149 Commissioner v. Harmon, 323 U.S. 44, 65 S. Ct. 103 (1944).

150 *Supra,* note 33.

so decreed; and each was taxable upon one half at his death[151] or upon one half the value of a gift made from it.[152] In 1942, however, the Code was amended to provide that the gross estate of the decedent should include:

> ". . . the interest therein held as community property by the decedent and surviving spouse under the law of any State, Territory, or possession of the United States or any foreign country, except such part thereof as may be shown to have been received as compensation for personal services actually rendered by the surviving spouse or derived originally from such compensation or from separate property of the surviving spouse. In no case shall such interest included in the gross estate of the decedent be less than the value of such part of the community property as was subject to the decedent's power of testamentary disposition."[153]

The constitutionality of this section was upheld in *Fernandez v. Weiner*[154] and *United States v. Rompel*[155] decided in 1945. In the former case the couple had been domiciled in Louisiana. Upon the death of the husband an estate tax was imposed upon the value of the whole community. In upholding the validity of Section 811(e)(2), the Court stated:

> ". . . the death of the husband of the Louisiana marital community not only operates to transfer his rights in his share of the community to his heirs or those taking under his will. It terminates his expansive and sometimes profitable control over the wife's share, and for the first time brings her half of the property into her full and exclusive possession, control and enjoyment. The cessation of these extensive powers of the husband, even though they were powers over property which he never "owned," and the establishment in the wife of new powers of control over her share, though it was always hers, furnish appropriate occasions for the imposition of an excise tax."[156]

Again, vested rights were disregarded and command over the property was considered to be of paramount importance to the tax issue.

Although Section 811(e) has limited the application of this theory by excepting from the estate tax property economically attributable to the survivor, it also provides that the decedent's estate shall in no case be taxed on less than the value of the property over which he or

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151 Liebman v. Fontenot, 275 Fed. 688 (D.C., W.D., Louisiana, 1921); Esperson v. Commissioner, 49 F.(2d) 259 (C.C.A. 5th, 1931); See also, Paul, *Federal Estate and Gift Taxation* (1942), Sec. 4.11 and cases cited in note 29 of that section.

152 Although this is the general rule, there are exceptions to it because of variations in the state community-property systems. See Paul, *ibid*, Sec. 16.17, for a discussion of the matter.

153 I.R.C., Sec. 811(e)(2).

154 326 U.S. 340, 66 S. Ct. 178 (1945).

155 326 U.S. 367, 66 S. Ct. 191 (1945).

156 *Supra*, note 154, at 355.

she held a power of testamentary disposition. While consistent with a "control" concept of taxation, this limitation often brings about a harsh result when the wife is first to die. Even though the husband contributed all the assets to the community, one half the value of the estate is taxable upon the wife's death, and should she leave her portion of the property to him, one and one-half times the customary amount of estate tax might very well be paid on the property in the space of one generation. If the origin of the assets cannot be proved, a serious situation may arise upon the death of either spouse, as the burden is upon the estate to prove what portion of the property has been acquired through the efforts of the survivor, if the tax is to be diminished.[157] Although the section has received some approval, censure of it has been severe; some critics being of the opinion that it is based on a complete misapprehension of the community-property system[158] and that the sentence providing for a tax on the testamentary estate in any event was really the result of a congressional oversight.[159]

A further disadvantage to the survivor of the community lies in the fact that his share of the property retains its community cost basis, even though it has been included in the gross estate of his spouse; and only the cost basis of the share subject to a power of testamentary disposition by the decedent is raised to its market value at the date of his death.[160]

The gift-tax law was also changed in 1942 to provide that gifts made from community property should be considered gifts of the husband, except to the extent that they were shown to be economically attributable to the wife.[161] As a result, the husband would normally pay all the tax on a gift, whereas if the same property were retained in the community, at least one half of it would be considered the wife's for the purpose of the estate tax at her death.

As to transfers between the parties, the regulations provide that the same rule which is applicable to gifts made from the community to third parties shall apply:

> ". . . to a division of such community property between husband and wife into the separate property of each, and to a transfer by the husband and wife of any part of such community property into the separate property either of the husband or of

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[157] Treas. Reg. 105, Sec. 81.23.

[158] de Funiak, "The United States Supreme Court and the Wiener Case," 23 Notre Dame Lawyer 28 (November, 1947); Hudspeth, "Minimizing Federal Estate Taxes in Community Property States," 24 Tex. L. Rev. 483 (June, 1946); Nossaman, "Taxation of Community Property," 83 Trusts and Estates 161 (Aug., 1946); Winstead, "Constitutionality of Federal Estate Taxation of Community Property," 24 Tex. L. Rev. 34 (Dec., 1945).

[159] Irion, "The Surviving Husband and the Wiener Case," 25 Taxes 64 (Nov., 1947); Winstead, *supra*, note 158.

[160] I.R.C., Sec. 113(a)(5).

[161] I.R.C., Sec. 1000(d).

treated in the opinion. In the *Clifford* case, the next development, the Court went a step further and determined that Clifford remained the owner of the income merely "for the purposes of Section 22(a),"[165] and relied upon that section with even greater firmness than it had in the assignment case. "Dominion and control" made its appearance in this opinion, together with its teammate, "special scrutiny." These same notions were carried forward into the *Lusthaus* and *Tower* cases and used as the basis of a new legal concept; the rule that a pure gift of a partnership interest from one spouse to another has no significance from the tax viewpoint.

The *Horst* case,[166] although decided before the partnership cases, represents the culmination of the engrafting of economic upon legal theory. It was decided, not on a theory of continued dominion and control equating to ownership, but on the basis of "nonmaterial satisfactions," equivalent to income, which the taxpayer had derived from the disposal of his right before it had become realized income to him.

Both types of reasoning have been developed in and largely confined to situations involving family relationships and for the purpose of preventing intra-family transfers to achieve tax reductions. Although apt to be offensive to the legalistic mind, they made possible judicial blocking of income-tax shifting in common-law states at a time when both Congress and the courts found it feasible to continue to treat the family ostensibly, at least, as so many independent persons rather than as a unit or a group.

But income-tax inequalities have not been limited to the differences in treatment of residents of civil-law and common-law states. They have also existed between propertied persons in the states following the common-law tradition and those residents who are dependent solely upon wages and salaries for their livelihood. The former are the ones who have been in a position to set up partnerships and trusts and to make use of property transfers calculated to put ownership of income in the name of the spouse in the favored surtax brackets. Persons relying wholly upon their present labors for support have had no such way of shifting the tax.

The household in which the wife works outside the home has also been at a disadvantage. Personal exemptions and expense deductions remain the same in such cases, although the working wife has additional expenses to meet. All these problems have been accentuated, of course, by the high surtax rates of recent years and the levying of income taxes on the lower-wage groups.

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[165] *Supra,* note 94, at 336.
[166] *Supra,* note 44.

Although the estate-tax base is less broad, its rates, too, have been high.[167] However, from a legal standpoint it has evoked less criticism than has the income tax. Since estate taxation is almost invariably connected with family transfers, legislators probably visualize the effects of the law in terms of such situations, and, as a result, although the estate-tax sections are general in their wording and decree the same results in all cases, still they are geared to the family situation, and, consequently, there has been less need for reliance on the judiciary to fit them to this particular type of case. To some extent the ideas of dominion and control, practical ownership, and special scrutiny have made their way into this field, but the inroads have never been so great as they have been with regard to income taxes.

IV. Suggested Changes in Family Tax Law

The need for basic changes in tax law as it affects the family has long been apparent, and several suggestions have been made. One of the first was that of compulsory joint returns.[168] Under such a system husband and wife, or even husband, wife and minor children, would be required to report their total receipts as one amount; the tax being computed at a rate applicable to the sum of their earnings. The system has much to commend it. It is realistic in that it treats the family as the unit which it actually is, and it offers a simple solution to the income-tax shifting problems of past years. Since there would be only one unit of income, it would make no difference from a tax point of view how much of it was contributed by each member of the family group. The pressure to equalize the incomes of household members would be relieved, and property transfers, for whatever reason entered into, would be made without hope of gain or fear of loss from the taxation viewpoint. Although considered at intervals, the plan has always had too many opponents to be politically feasible.[169] Moreover, a similar system of income taxation was attempted in Wisconsin and

[167] Professor Magill is quoted in Osgood, "Repeal the Federal Estate Tax," 84 Trusts and Estates 246 (Feb., 1947), as having stated that "the present yields may be considered close to the possible maximum."

[168] See discussions of the plan in: Jaszi, "Treatment of Married and Single Persons under the Individual Income Tax," 20 Taxes 259 (May, 1942); Ray, "Proposed Changes in Federal Taxation of Community Property: Income Tax," 30 Cal. L. Rev. 397 (May, 1942); Reiling, "Taxing the Income of Husband and Wife," 13 Tax Mag. 198 (April, 1935); Surrey, "Family Income and Federal Taxation," 24 Taxes 980 (Oct., 1946); "Revenue Revision—1948," Report of the Special Tax Study Committee on Ways and Means, U.S. House of Representatives.

[169] The community-property states have always objected to the plan, since it would disregard the local law that one-half the community income belongs to the wife.

declared unconstitutional by the United States Supreme Court in 1931.[170]

A second revision often suggested is the splitting of incomes;[171] a method whereby the total income of the family is divided equally between the spouses. The tax is then computed at the applicable rate on each half and the two taxes added together and reported on one joint return. This plan has been subjected to less opposition than the other. It gives the benefits of the community-property system to married couples in common-law states, treating husband and wife as partners for income-tax purposes. Incorporated into the 1948 Revenue Act, it results, of course, in lowered income-tax receipts from the common-law states. However, this situation may ultimately be corrected by adjustment of the rates to produce the required revenue, and at the same time it will lead to a more equitable distribution of the tax burden.

Suggestions for change in the estate and gift-tax laws have been concerned mostly with a better correlation of the two taxes and in such a manner as to cause less conflict with income-tax requirements. Foremost among such plans is that formulated by the Advisory Committee to the Treasury Department and calling for an integrated transfer tax which would take the place of the presently unrelated estate and gift taxes.[172] An effort is made to define sharply the instant when change of ownership takes place, at which time the single transfer tax is imposed and the former owner's income-tax liability ceases. Although not directly concerned with the problem of family treatment, it would have a beneficial effect as it would do away with the multiple taxes which now often result from intra-family transfers.

V. The Revenue Act of 1948

Out of the mistakes of the past and the suggestions for their correction has emerged the Revenue Act of 1948. Its most publicized feature is its income-splitting provision, whereby it is now possible for spouses electing to file joint returns to divide their total income in half. The applicable surtax rate is applied to the quotient and the resulting tax is then multiplied by two.[173] This method produces tax savings in any case in which the total income falls outside the first surtax bracket. It equalizes the treatment of married residents of community and non-

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170 Hoeper v. Tax Commission of Wisconsin, 284 U.S. 206, 52 S. Ct. 120. The significance of this case is left in doubt. Although the act apparently provided that liability for the tax should rest upon each member of the family in proportion to his contribution to the total income, the Court paid little heed to this provision.

171 *Supra,* note 168.

172 The plan is embodied in a report entitled, "Federal Estate and Gift Taxes—A Proposal for Integration and for Correlation with the Income Tax" (1947).

173 Revenue Act of 1948, Sec. 301, Slip Laws, Chap. 168, Public No. 471 (Approved, April 2, 1948).

community property states and puts on an equal plane couples receiving investment and those receiving earned income only. Even in a community-property state spouses may benefit by the new act, which makes it possible for them to divide for tax purposes their separate as well as their community income.

Although problems are bound to arise under the new method of income taxation, it does seem reasonable to suppose that to some extent, at least, it will solve the problems in answer to which it was drafted.[174] It does not treat the family as a unit, as has often been suggested, but instead places husband and wife somewhat in the position of common-law partners, entitled to equal shares of the income or profit from their joint venture. The act does not, however, obliterate former tax case-law. Since it is concerned only with the income of husband and wife, there is still the possibility that spouses will attempt to reduce their tax bills by making other family members, especially minor children, nominal owners of some of their income, and the old rules would still apply to such attempted transfers. However, the incentive to shift taxes in this manner is much lessened by the relief which has been granted and by the equalized treatment of all married couples.

The plan makes no attempt to solve the problem of proper tax treatment of the single person, and particularly the single person with dependants, who must pay taxes out of proportion to those of the married couple, since he is denied the splitting advantage because of his marital status. An evaluation of this problem is chiefly an economic rather than a legal matter, but it presents one of the most difficult of tax reappraisement tasks.[175]

Although less widely discussed, the estate and gift-tax changes made by the new law are much more novel and far-reaching in their effects than those of the income-tax sections. Completely new concepts are introduced, the most important being the "terminable interest" and the "adjusted gross estate." An about-face is made with regard to the determination of ownership of property, as local law, formerly apt to be disregarded, has again become the criterion.

Specifically, the 1948 Act provides that spouses may dispose of as much as one half of their property to each other without tax incidence.

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[174] The Report of the Senate Finance Committee, No. 1013, 80th Congress, 2nd Session, lists these problems on page 22 as the differential treatment of community and non-community property state residents; the tax advantages open to owners of investment income as against wage-earners; the difficulties of tracing and of keeping records which will enable community-property state residents to distinguish between community and separate income; the use of tax-shifting devices in non-community states; and the inclination of common-law states to adopt the community-property system to achieve tax savings for their citizens.

[175] For a discussion of problem from an economic viewpoint, see, Jaszi, *supra*, note 168, and Surrey, *supra*, note 168.

By section 361 of the Act, Section 812 of the Code is amended to allow as an additional deduction in computing the net estate:

> "An amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate."

This section is limited, however, by subsection (B), which provides:

> "Where, upon the lapse of time, upon the occurrence of an event or contingency, or upon the failure of an event or contingency to occur, such interest passing to the surviving spouse will terminate or fail, no deduction shall be allowed with respect to such interest—
>
> "(i) If an interest in such property passes or has passed (for less than an adequate and full consideration in money or money's worth) from the decedent to any person other than such surviving spouse (or the estate of such spouse): and
>
> "(ii) If by reason of such passing such person (or his heirs or assigns) may possess or enjoy any part of such property after such termination or failure of the interest so passing to the surviving spouse;
>
> and no deduction shall be allowed with respect to such interest (even if such deduction is not disallowed under clauses (i) and (ii)—
>
> "(iii) If such interest is to be acquired for the surviving spouse, pursuant to directions of the decedent, by his executor or by the trustee of a trust."

The committee has expressed its intent that (i) and (ii) be broadly interpreted to include all types of interests passing to others for less than a full consideration and which may be enjoyed after the termination of the interest given to the husband or wife.[176] For example, if property is given to a wife and child as joint tenants, the marital deduction will not be allowed against the wife's interest, since the child has acquired, for less than a full consideration, an interest in the property which may extend beyond that of the wife. On the other hand, however, if the husband were to sell realty, but to retain a twenty-year lease, and later left his ful interest in the lease to his wife, a marital deduction could be taken. In that case the "property" would be the lease and the wife would have received the full "interest" in it.

Subsection (F) contains an exception to (iii) and makes subject to the marital deduction property passing from the decedent in trust for the benefit of his wife on the condition that the income from such property be payable to her at least annually and that she have a general power of appointment over the corpus, exercisable either in favor of

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[176] Supplementary Report of the Committee on Finance, No. 1013, Part 2, 80th Congress, 2nd Session, p. 3.

herself or her estate.[177] Although she may also have the power to appoint to others, a power given to any other person must be limited only to the right to appoint to her.

The marital deduction is allowed to the extent of one half the "adjusted gross estate," defined in Section 361(a)(2) of the Act as the entire value of the gross estate less the deductions allowed under Section 812(b) of the Code.[178] The value of any property held in community may not be included in the adjusted gross estate,[179] for the reason, of course, that the surviving spouse takes his or her half interest in the community free from tax and thereby obtains the same tax advantage flowing from the granting of the marital deduction in other cases. The interest of the survivor, however, now has the same cost basis as that of other property transferred at death.[180]

The purpose of the act is to achieve substantial equality between residents of community and non-community property states[181] by granting to the latter the privilege of transferring half of the estate to the surviving spouse free from tax. Since, however, the transfer in a community- property state results in a fee, the marital deduction is not allowed in cases of transfers of separate property unless the grant is substantially that. As a result, there will probably be more absolute gifts and devises and fewer transfers of limited interests in the future, since it is only through the making of the former that married couples may take advantage of the tax savings now open to them.

Gifts to third persons will, in the future, be considered as having been made one-half by each spouse, if the couple desires to have them so treated.[182] An inter vivos gift to a spouse is also subject to a marital deduction equal to one-half its value, unless the gift is classified as a terminable interest.[183] This rule does not apply to gifts from community property.

The future of the new law is still unknown; but in the family tax field, at least, it does seem to bring promise of more equity and certainty in its operation than did the previous enactments. Although the importation of new terms and the reliance on local law to determine ownership will, no doubt, give rise to a certain amount of litigation, the law should operate more and more smoothly as various of these questions are settled. At any rate, it represents a worthwhile attempt at the solution of tax problems in this field through basic and correlated changes rather than by detail redesigning.

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[177] *Supra,* note 173, Sec. 361(a).
[178] Generally, the deductions allowed under this section are expenditures for funeral and administration expenses, taxes paid, and claims against the estate.
[179] *Supra,* note 173, Sec. 361(a).
[180] *Ibid,* Sec. 366.
[181] *Supra,* note 174, at p. 27.
[182] *Supra,* note 173, Sec. 374.
[183] *Ibid,* Sec. 372.